

DEPARTMENT OF STATE REVENUE
LETTER OF FINDINGS NUMBER 97-0567 ST
SALES AND USE TAX

For Tax Periods: 1993 Through 1995

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ISSUES

1. Sales and Use Tax-Mineral Oil

Authority: IC 6-2.5-4-2 (a), Gross Income Tax Division v. National Bank and Trust Co., (1948) 226 Ind. 298, 79 N.E. 2d 651, IC 6-2.5-5-3, 45 IAC 2.2-5-14.

Taxpayer protests the assessment of additional tax on mineral oil.

2. Sales and Use Tax-Aeration Equipment

Authority: IC 6-2.5-5-2.

Taxpayer protests the assessment of additional tax on aeration equipment.

3. Sales and Use Tax-Safety Shoes

Authority: 45 IAC 2.2-5-8-(2)(F).

Taxpayer protests the assessment of additional tax on safety shoes used in the manufacturing process.

4. Sales and Use Tax-Utilities

Authority: IC 6-2.5-5-5.1, Information Bulletin #55 (May 31, 1989).

Taxpayer protests the assessment of additional tax on utilities.

5. Sales and Use Tax-Testers

Authority: 45 IAC 2.2-5-8 (i).

Taxpayer protests the assessment of additional tax on testers.

6. Sales and Use Tax-Dust Suppression Oil

Authority: IC 6-2.5-5-3, IC 6-2.5-5.1.

Taxpayer protests the assessment of additional tax on dust suppression oil

7. Sales and Use Tax-Electricity at Leased Facility

Authority: IC 6-2.5-2-1 (b).

Taxpayer protests the assessment of additional tax on electricity at a leased facility.

8. Sales and Use Tax-Assets Used in Production

Authority: IC 6-2.5-5-3 (b).

Taxpayer protests the assessment of additional tax on assets used in production.

9. Sales and Use Tax-Fertilizer Applicators

Authority: Information Bulletin #9.

Taxpayer protests the assessment of additional tax on fertilizer applicators.

10. Tax Administration-Penalty

Authority: IC 6-8.1-10-2 (a).

Taxpayer protests the assessment of the ten per cent 10 % penalty.

Statement of Facts

Taxpayer is a marketer, processor and distributor of agricultural, food and industrial products. After an audit, the Indiana Department of Revenue assessed additional sales and use taxes against Taxpayer. Taxpayer protested the assessment. Further facts will be provided as necessary.

Discussion

1. Sales and Use Tax-Mineral Oil

Pursuant to IC 6-2.5-3-2(a), Indiana imposes an excise tax on tangible personal property stored, used, or consumed in Indiana. A number of exemptions are available from use tax, including those collectively referred to as the manufacturing exemptions. All exemptions must be strictly construed against the party claiming the exemption. Gross Income Tax Division v. National Bank and Trust Co., (1948) 226 Ind. 298, 79 N.E. 2d 651. IC 6-2.5-5-3 provides for the exemption of "manufacturing machinery, tools and equipment which is to be directly used by the purchaser in the direct production, manufacture, fabrication . . . of tangible personal property."

Taxpayer's first point of protest concerns the assessment of additional tax on mineral oil. This oil is sprayed on the grain during loading and unloading. Taxpayer contends that the oil becomes an integral and material part of the grain and thus qualifies for

exemption pursuant to 45 IAC 2.2-5-14. The dust suppression oil does soak into the grain and become part of it. It does not, however, complete or alter the grain. Also, it is added during loading and unloading rather than during the production process. The primary objective of the oil appears to be suppressing dust and improving the work environment. Therefore, the mineral oil does not qualify for exemption.

Finding

Taxpayer's first point of protest is denied.

2. Sales and Use Tax-Aeration Equipment

Taxpayer's second point of protest concerns the assessment of additional tax on aeration equipment. The aeration equipment is used in conjunction with the drying equipment during the production process to reduce grain moisture to desired levels and maintain grain moisture at desired levels. To the extent this equipment actually dries the grain, it has a direct effect on the grain during the production process and qualifies for exemption pursuant to IC 6-2.5-5-2 because it is directly used "in the direct production, extraction, harvesting, or processing of agricultural commodities." The use of the aeration equipment to maintain moisture levels at desired levels does not have the requisite effect on the grain to allow exemption as directly used in direct production.

Finding

This point of protest is sustained to the extent the equipment is used to actually dry grain. This point of protest is denied to the extent the equipment is used to merely maintain desired moisture levels.

3. Sales and Use Tax-Safety Shoes

Taxpayer's third point of protest concerns the assessment of additional tax on safety shoes used in the production process. These safety shoes are worn in the steel plant and protect the employees' feet when they come into contact with steel fragments. 45 IAC 2.2-5-8(2)(F) states that clothing required for protection of employees in the production process is exempt.

Finding

This point of protest is sustained.

4. Sales and Use Tax-Utilities

Purchases of electricity in Indiana are subject to the sales/use tax unless they are "consumed in the direct production of other tangible personal property in his business of manufacturing" IC 6-2.5-5-5.1. Information Bulletin #55 (May 31, 1989) provides that all metered electricity used in a manufacturing facility will be considered exempt if the electricity is predominately (more than 50%) consumed in the operation

of exempt machinery. Taxpayer alleges that the subject electricity was separately metered and did not include any of the electricity used in office or administrative capacities. Taxpayer had a utility study performed by an outside engineering firm. That study found that the subject electricity was predominately used for exempt equipment and therefore qualified for a 100% exemption. That study was performed, however, prior to the hearing. The hearing findings concerning the exemption of certain pieces of machinery would affect the results of the electricity study.

Finding

The auditor is to recalculate the utility study. This recalculation should reflect the findings concerning the exempt status of the various pieces of machinery considered in the hearing. The protest is sustained if the recalculation also finds that the electricity is predominately used to power exempt uses of Taxpayer's machinery.

5. Sales and Use Tax-Testers

Taxpayer's fifth point of protest concerns the assessment of additional gross retail tax on testers used in the Steel & Wire Division. This division receives steel coil that it unrolls for processing. The subject testers measure the topography or texture of the steel before the production process so that Taxpayer can produce a steel product that meets the customers' specifications. 45 IAC 2.2-5-8(l) provides that equipment and machinery that is used during the integrated production process is exempt from the gross retail tax. These testers do not meet that qualification for exemption.

Finding

This point of Taxpayer's protest is denied.

6. Sales and Use Tax-Dust Suppression Oil

The dust suppression oil is sprayed onto the phosphate fertilizer. It is very similar in function to the mineral oil discussed in point # 1 of this Letter of Findings. Pursuant to the manufacturing exemption, an item qualifies for exemption only if it has an immediate effect on the product being produced during the production process, IC 6-2.5-5-3, or is consumed and becomes an essential and integral part of the product being produced, IC 6-2.5-5-5.1. This oil is used during the loading process after the end of production. The main purpose of this use of the oil is to improve the work environment. Therefore this item does not qualify for exemption.

Finding

This point of Taxpayer's protest is denied.

7. Sales and Use Tax-Electricity at Leased Facility

Taxpayer leased this facility. The lessor paid the electric bill and accompanying sales taxes and was reimbursed by Taxpayer. The lessor was the actual customer of the electric utility and acquirer of the electricity. Therefore, pursuant to IC 6-2.5-2-

1(b), the lessor was the proper person to pay the subject sales taxes and the person who actually paid the subject sales taxes.

Finding

Taxpayer's protest to the assessment of additional sales taxes on the electricity at the leased facility is sustained.

8. Sales and Use Tax-Assets Used In Production

Pursuant to IC 6-2.5-5-3(b), property directly used in direct production is afforded a manufacturing exemption from the gross retail tax. Taxpayer protests the assessment of additional use tax on several pieces of equipment. The first piece is an auger that moves previously dried salt to a bin where it is temporarily stored before the next step in the production process. This item is used to transport product in production and qualifies for exemption.

The second item is a self-cleaning magnet that prevents foreign materials from contaminating the salt. This piece of equipment is necessary and essential to the production of the salt since contaminated salt would not function properly in water softeners. The magnet has a direct effect on the salt because it keeps it uncontaminated and useful. The purpose of this equipment is to work on the salt being produced rather than to keep the environment clean. This piece of equipment qualifies for exemption.

The third point of this item of protest concerns the tax assessed on several conveyors that carry the salt throughout the integrated production process. These conveyors are necessary and essential to the production process. These conveyors qualify for exemption.

The fourth item is a rotex screener, which is used to prevent any non-metallic material from being mixed in with the salt before it goes into the hopper. This screener is analogous to the self-cleaning magnet and qualifies for exemption for the same reasons.

The fifth item is the big blaster found in the hopper. Its purpose is to break up salt that accumulates on the sides of the hopper. This is a cleaning and maintenance function that does not qualify for exemption.

The final item is the scale used to weigh the salt before it is placed into bags. The manufacturing process includes the initial packaging of the product. Customers order differing weight bags of salt. Therefore, a scale is essential to the packaging of the product and is exempt from gross retail tax.

Finding

Taxpayer's protest is sustained in part and denied in part.

9. Sales and Use Tax-Fertilizer Applicators

Taxpayer protests the assessment of tax on fertilizer applicators. Taxpayer sells fertilizer to farmers and actually spreads the fertilizer on its customers' fields. The audit assessed gross retail tax on the machines that spread the fertilizer on the fields. This piece of machinery qualifies for exemption pursuant to the reasoning of Information Bulletin # 9 concerning agricultural product exemptions. Taxpayer's situation is identical to example # 5 that concerns the exempt status of chemical applicator machinery that a chemical producing company uses to apply chemicals necessary to the production of agricultural products.

Finding

This point of protest is sustained.

10. Tax Administration-Penalty

Taxpayer's final point of protest concerns the imposition of the negligence penalty that was imposed pursuant to IC. 6-8.1-10-2 (a) which states as follows:

If a person fails to . . . pay the full amount of tax shown on his return on or before the due date for the return or payment, incurs, upon examination by the department, a deficiency which is due to negligence,. . . the person is subject to a penalty.

Taxpayer operates a diverse and complex series of industrial concerns. Taxpayer exhibited a high degree of compliance with the gross retail tax laws and cooperated with the auditors in attempting to determine the correct amount of tax due to the state.

Finding

Taxpayer's protest to the imposition of the negligence penalty is sustained.